



22 November 2004

Mr Scott Gregson
General Manager, Adjudication Branch
Australian Competition & Consumer
Commission
PO Box 1199
DICKSON ACT 2602

Attention: Mr David Hatfield

Dear Mr Gregson

PWCS Authorisation Application (A30236-A30238)

Introduction

Xstrata remains highly supportive of the PWCS proposed Medium Term Capacity Distribution System ("MTCDS").

Xstrata would like to respond as a coal producer to some of the factual issues raised in the NCIG submission.

Xstrata respectfully requests that the Commission does not impose any conditions on the Authorisation that prevents the MTCDS extending from year to year until the long term solution to the capacity shortage at Newcastle is put in place. Xstrata is comfortable with such extensions because of the existing condition already involved in the MTCDS, which means that the capacity distribution under the MTCDS does not operate unless there is demonstrated excess demand over capacity of 3 million tonnes. In Xstrata's view this is far preferable from a rational, economic efficiency perspective, than the imposition of conditions based on the subjective views of individual producers.

The issues and suggested solution

PWCS has carried out extensive industry consultation in relation to the proposed changes to the Coal Handling Services Agreement ("CHSA") and the Protocol dealing with the MTCDS which is Annexure 4F to the CHSA. Xstrata believes that consultation has been more than comprehensive and it is now time to implement the MTCDS to ensure the Port continues to operate efficiently to the benefit of coal exporters.

XCN Coal (NSW) Pty Limited ABN 18 097 523 258

PMB 8 Singleton NSW 2330 Australia / Broke Road Singleton NSW 2330 Australia

Tel +61 2 6570 2497 Fax +6570 2505 www.xstrata.com



As far as Xstrata is aware, the only two remaining issues that have been raised by industry participants as part of that consultation process, have been raised by the NCIG. The first issue that NCIG has raised is an objection to the take or pay arrangements. NCIG has sought from the Commission a condition to the authorisation that they be included in Annexure 4F so that they only operate for one year in advance and that they should not be changed without industry agreement.

The second issue that NCIG have sought is a condition that PWCS obtain agreement from 75% by volume *and* 50% by number of coal producers exporting through PWCS, *before* the MTCDS can be extended on a yearly basis.

Xstrata would like to deal with these requested conditions in the context that NCIG in its letter dated 19 November 2004 has stated that:

- NCIG is seeking that PWCS provide “a firm plan to achieve a capacity of at least 125Mtpa”; and
- “NCIG is prepared to establish a third independent coal-loader”.

Xstrata believes that the NCIG conditions need to be considered in the context that NCIG is putting forward what appear to be contradictory positions. First, that it is up to PWCS to find a solution to find capacity of 125Mtpa at Newcastle - Xstrata believes that PWCS as a port operator would find it difficult to achieve such capacity not only in the face of NCIG's requested condition of limiting take or pay to one year terms, but also because increasing capacity at Newcastle is dependent on a variety of factors, in particular the terminal / rail infrastructure linkage.

Second, even if NCIG were to seek to build a new coal terminal at Newcastle as they have indicated, that would take in the order of 4-5 years at a cost of \$300 million to \$400 million. Such a coal terminal would not necessarily substantially increase capacity at Newcastle without additional and extensive upgrading of the rail infrastructure network by ARTC and the rail provider, be it Pacific National or Queensland Rail.

Accordingly, the request for additional conditions on PWCS should perhaps be considered as a strategic option which fetters a competing terminal and raises a rivals cost, **particularly in the practical situation that a rival terminal is highly unlikely to be built and operating within the 3-5 year timeframe requested by PWCS for its authorisation.**

In these circumstances, if the Commission wishes to deal with concerns raised by NCIG, it can easily do so by requiring the 3 million tonne condition (thereby dealing with the 50% industry support condition and not making the MTCDS subject to subjective producer goals - whether against or for the MTCDS as the threshold test is a factual test based on demand) as well as limiting the authorisation to 4 years if a rival terminal is built and operating - if not then 5 years - therefore dealing with the take or pay issue raised by NCIG. As a coal producer Xstrata notes that if a terminal is going to be up and running and the alternative coal terminal offered more attractive



terms, then coal producers would not pre-commit coal to the PWCS terminal. This would address the competitive concern raised by NCIG as well as giving PWCS the opportunity to use take or pay contracts to expand the existing operations - again something that NCIG as well as the industry as a whole are seeking.

These issues are now considered in more detail.

The take or pay issue

Xstrata strongly supports the principles of take or pay and notes that take or pay arrangements are the industry norm for logistics arrangements in the coal industry throughout the world. Xstrata, along with other coal companies, has much more onerous take or pay arrangements with other parties for track, above rail and other port contracts than are proposed by PWCS. Xstrata supports take or pay arrangements as they are a fundamental requirement to provide reasonable certainty of forecast requirements both in terms of ensuring your particular coal is shipped, as well as ensuring some producers do not allow loading allocation to be unused. Without sound commercial underpinnings such as take or pay, there can be no certainty of investment and tonnage outcomes.

Xstrata is concerned that if PWCS's commercial ability to enter into take or pay arrangements is restricted, Xstrata may suffer loss:

- PWCS may be unable to expand the port to meet future demand, as it would no longer have reliable forecasts and income. This in turn would restrict the sales of exporters such as Xstrata who are more than willing to enter into binding commitments for its activities.
- If PWCS does expand the port, but NCIG or other parties move to a new terminal, then Xstrata will be left to carry a disproportionate share of the expansion capital.

Further, Xstrata is of the view that take or pay outcomes are a contractual matter that can and is readily resolved through usual commercial negotiations without the need for the intervention of a regulator or other third party. For example, Xstrata is currently negotiating with Gladstone Port Authority and Pacific National for capacity, including provisions for long term take or pay arrangements, without the need for regulator input. It is up to the individual coal company to make its own planning arrangements.

Accordingly, the NCIG request for the Commission to impose a one year take or pay obligation as a condition is uncommercial as it would stultify investment by PWCS, undermine coal companies export contracts and have exactly the opposite effect of facilitating port expansion - what NCIG claim is their paramount concern.

As a further commercial and practical matter, Xstrata notes that PWCS has entered into extensive consultation, including industry surveys, meetings with all existing and prospective port users and detailed consultation on terms and conditions associated with the proposed take or pay. The resulting arrangements have achieved widespread support. PWCS is contractually committed to

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consult equally widely before proposing any changes. Should any party not be comfortable with any future take or pay proposal, it can raise any specific concerns once such a proposal has been made by PWCS. It is inappropriate for NCIG to seek to restrict the current authorisation because of speculation about what action PWCS may take in the future, especially given the rigorous process PWCS has followed to date. More importantly, any intervention by the Commission at the request of NCIG, which accepts it represents 6 of the 16 coal exporters, but only approximately 13 of the 96 million tonnes forecast for 2005 (which is less than 15% of the total projected supply) would override the contractual arrangements freely entered into by all PWCS customers, which provide specifically for the process by which changes to the CHSA will be handled by both sides and which account for the clear majority of export sales. This is particularly the case where NCIG states:

“NCIG is prepared to establish a third independent coal-loader, efficiently financed and operated independently of coal exporters.”

If NCIG is proposing to develop a new coal terminal, then it is not appropriate for NCIG as a potential competitor to seek to impose a condition which actually fetters the ability of PWCS to expand capacity for all coal exporters using take or pay contracts which underpin the financial viability of such an expansion. Xstrata would oppose any such condition being imposed on PWCS as it is more likely to do greater harm to coal exporters than any element of benefit.

MTCDS Extension

In relation to the 50% threshold, Xstrata takes the view that the key issue in an authorisation context is that the benefits of the MTCDS outweigh the detriments. Any provision which has the potential to defeat PWCS operating the MTCDS to obtain efficiencies, must surely have a detrimental effect. In contrast, it is difficult to point to any benefits of such a provision, particularly given the existing 3 million tonne threshold of demand exceeding capacity before the MTCDS is to operate in any calendar year.

Xstrata has supported the PWCS proposal for industry support as part of a consultation process resulting in industry consensus. However, NCIG have chosen to reject the proposal unless a specific test of “industry support”, notably a 50% by number test, is imposed separately to the 75% volume test. Xstrata submits that the Commission should not accept the condition for the following reasons:

- the MTCDS under the terms of the Protocol sought to be authorised only operates where the demand exceeds capacity by more than 3Mt - accordingly, there is already a threshold amount in the Protocol sought to be authorised and that threshold is not influenced by supporters or opponents of the MTCDS, but rather by an objective economic criteria;
- Xstrata submits that the NCIG claim that it accounts for “6 of 16” coal exporters through PWCS is potentially misleading. There are 20 potential coal export groups defined in the

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CHSA, but these groupings are administrative in nature. In ownership and economic terms, it is necessary to include all the different mines and their joint venture parties as it is at this level that production and sales decisions are made. For example, there are several independent parties included in the administrative group assigned to Rio (eg Wesfarmers, Mitsui, Posco) or Xstrata (eg Nippon Steel, Mitsubishi). Including the various parties which actually own mine shares, the number of exporting entities is over 50. To impose a condition which favours a small number of exporters is not appropriate;

- NCIG have indicated that they are potential establishers of a new coal loader. In these circumstances, no condition should in fact be imposed which fetters the existing coal terminal as a separate legal entity from expanding and which limits its commercial operations based on some form of industry agreement. To do so would benefit an alternative coal loader, in particular a loader which did not have common access provisions and thereby grant other coal producers an advantage. Indeed, an issue is squarely raised by NCIG's indication it may build its own coal-loader - it is conceivable that a conflict of interest may arise where producers may choose to reject the extension of the MTCDS or fetter its expansion to further their own plans for third party infrastructure arrangements; and
- Decisions on the operation of the MTCDS should not be based on the number of producers as there could be a multitude of small users who only make up a fraction of the throughput at the terminal. Xstrata notes that the PWCS industry support proposal could result in a situation where the producers representing only between 12-25% of throughput could block the extension of a scheme and hence lead to massive queuing again off the port, resulting in substantial public detriment. Again, this would not be an economically efficient result.

Conclusion

In conclusion, as one of the larger users of the PWCS coal terminal, Xstrata believes that the MTCDS has substantial public benefits and that on any view, the benefits outweigh the detriments. In these circumstances, the term of its authorisation should not be artificially limited by imposing some form of requirement of industry agreement.

Xstrata respectfully requests that the Commission to note that PWCS has gone to great lengths to seek to ensure that there is no limitations on coal industry expansion and there is efficient use of resources. NCIG's requests to impose conditions will in fact lead to PWCS being frustrated in expanding the port through the inability to use take or pay and its inability to modify the practical operation of MTCDS. For example even if sought authorisation and the Commission were minded to grant such authorisation, elements of the industry may not allow such an application to the Commission to proceed. The reality of the situation is brought home in those circumstances, "Industry support" as NCIG seeks, has little to do with the authorisation test. Any substantive

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economic issues as to the application of the MTCDS the subject of the proposed 50% condition sought by NCIG is already dealt with in the 3 million tonne capacity threshold.

In relation to the take or pay, there is commercially a very easy answer to the NCIG request. From Xstrata's experience, if a coal exporter believes that it will be able to use a new coal terminal at any given time, then it simply should not include its volume in any take or pay/forecast request and it take its own commercial and financial risk - rather than seeking to pass this on to the coal terminal. If that producer does not wish to use the available capacity at the coal loader, then another producer willing to take the capacity and pay for it should be entitled to do so. NCIG should not be permitted to have its "cake and eat it".

Yours sincerely

A handwritten signature in black ink, appearing to read 'M. Buffier', written in a cursive style.

Mick Buffier

Chief Operating Officer

A handwritten signature in black ink, appearing to read 'J. Ryan', written in a cursive style.

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